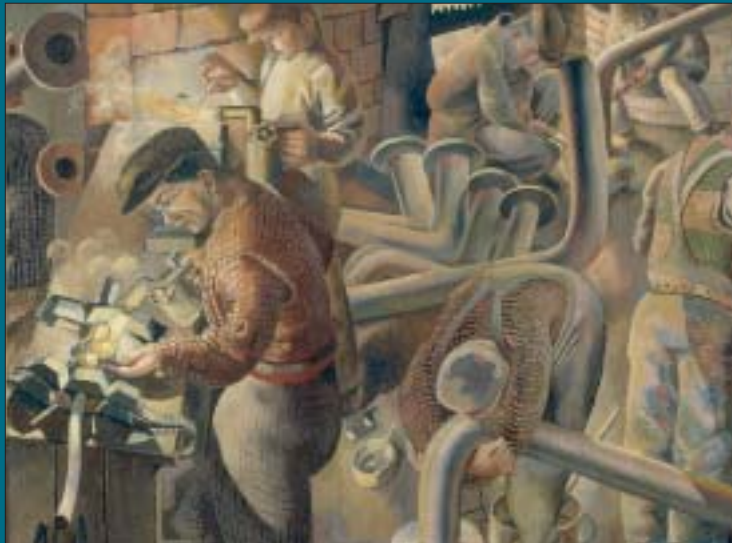


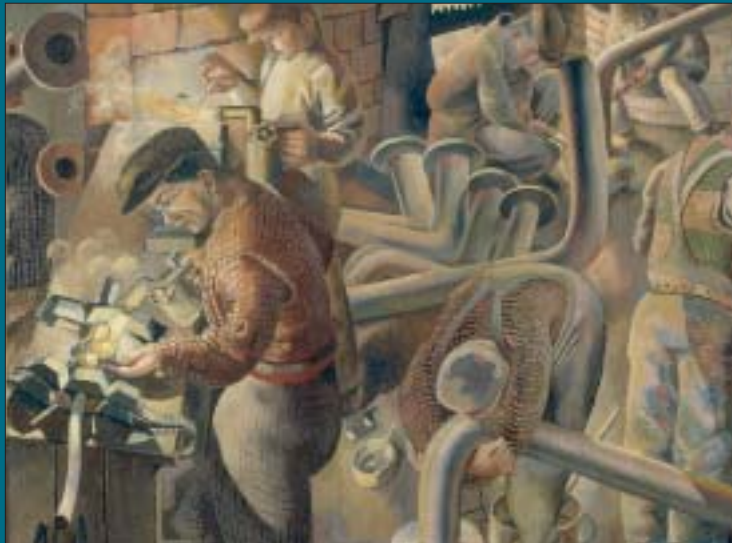
Shires Smaller Companies plc



Annual Report 2003

Managed By

GLASGOW
INVESTMENT MANAGERS



The painting on the front cover "Shipbuilding on the Clyde plumbers 2" is by Stanley Spencer (1891-1959) and was one of many commissioned of the Port Glasgow Shipyards chronicling the war effort during the Second World War. It is reproduced by kind permission of the Imperial War Museum.

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Company Administration

Managers, Secretaries and Registered Office

Glasgow Investment Managers Limited
Sutherland House
149 St Vincent Street
Glasgow G2 5DR
(Authorised and regulated by the Financial Services Authority)

Auditors

KPMG Audit Plc

Solicitors

Maclay Murray & Spens

Stockbrokers

Cazenove & Co
Williams de Broë Plc

Bankers

HSBC Bank plc

Registrars and Transfer Office

Lloyds TSB Registrars Scotland
PO Box 28448
Finance House
Orchard Brae
Edinburgh EH4 1WQ
Telephone 0870 601 5366

Company Registration Number

137448 (Scotland)

Company Profile

Objective

The objective of the Company is to provide a high and growing dividend and capital growth from a portfolio invested principally in the ordinary shares of smaller UK companies and UK fixed income securities.

Benchmark

FTSE SmallCap Index – excluding Investment Companies (Total Return).

Capital structure

Ordinary shares in issue	21,886,538
9% Loan repayable at par in 2005	£10,000,000

Additional gearing is provided by medium-term funding in the form of zero coupon finance repayable in 2005 and 2008 (see note 16).

Dividends

Dividends on the ordinary shares are payable quarterly at the end of January, April, July and October. This is a change from previous dividend dates as fully described on page 7.

Continuation Vote

The Company's Articles of Association require that an ordinary resolution is proposed at the eighth and then every fifth Annual General Meeting to allow the Company to continue as an investment trust for a further five year period. The present five year mandate expires at the Annual General Meeting due to be held in March 2005.

Management Company and Fee

Glasgow Investment Managers ("Glasgow") acts as Managers and Secretaries to the Company under a management contract which is terminable by one year's notice on either side. The fee is at the rate of 0.75% of shareholders' funds plus medium and long-term funding.

PEPs and ISAs

The Company's ordinary shares are available for investment in PEPs and ISAs.

AITC

The Company is a member of the Association of Investment Trust Companies (AITC).

Financial Information

Highlights

	As at 31 December 2003	As at 31 December 2002	% increase
Total assets less current liabilities	£64.64m	£56.49m	14.4
Shareholders' funds	£38.87m	£32.31m	20.3
Market capitalisation	£40.27m	£30.53m	31.9
Net asset value (NAV) per share	177.6p	147.6p	20.3
Ordinary share price	184.0p	139.5p	31.9
Premium/(Discount) (share price to NAV)	3.6%	(5.5%)	-
Revenue return per share	14.46p	13.77p	5.0
Dividends per share	13.75p	13.75p	0.0
Total expense ratio	2.24%	2.09%	-
Gearing	72.2%	84.7%	-

Year's high and low	Year to 31 December 2003		Year to 31 December 2002	
	High	Low	High	Low
NAV per ordinary share ¹	183.6p	133.7p	217.0p	147.6p
Ordinary share price	195.0p	121.5p	216.0p	139.5p
Premium/(Discount)	5.3%	(9.1%)	9.9%	(9.0%)

Performance – Total Return

	1 year %	3 years %	5 years %
Shires Smaller Companies plc			
– Net asset value total return	29.6 ²	(8.4) ³	33.2 ³
– Share price total return	41.8 ²	15.8 ³	96.1 ³
FTSE SmallCap Index (excluding Investment Companies)	40.9 ⁴	(14.0) ⁴	41.1 ⁴
FTSE All-Share Index	20.9 ⁴	(19.0) ⁴	(5.3) ⁴

All figures are total return and assume re-investment of net dividends excluding transaction costs.

	As at 31 December 2003	As at 31 December 2002
Net dividend yield		
Shires Smaller Companies plc ⁵	7.5%	9.9%
FTSE SmallCap Index (excluding Investment Companies)	2.5%	3.5%
FTSE All-Share Index	3.1%	3.6%

¹ Based on month-end values.

² Source: Glasgow Investment Managers Limited.

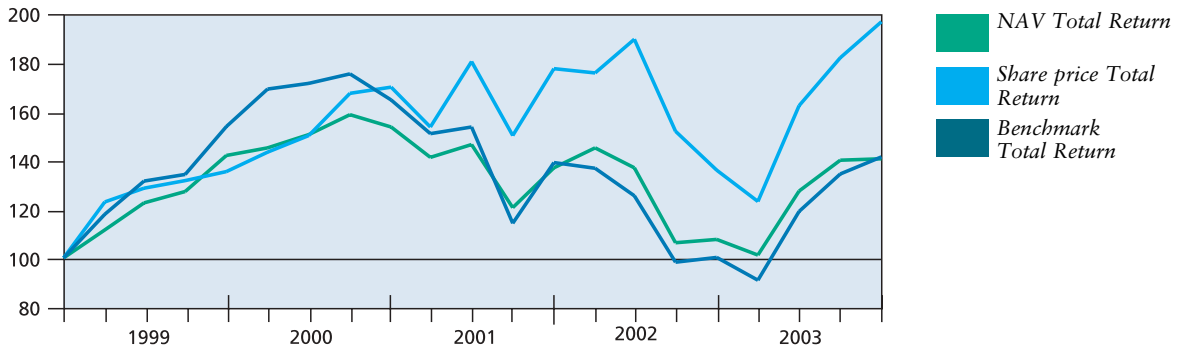
³ Source: Fundamental Data for the Association of Investment Trust Companies.

⁴ Source: Datastream.

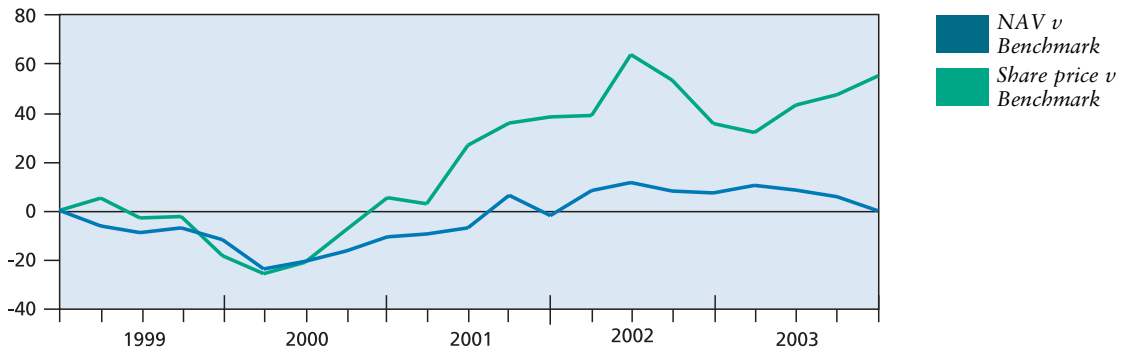
⁵ Based on share price and proposed total dividend for the year ended 31 December 2003.

Absolute Performance

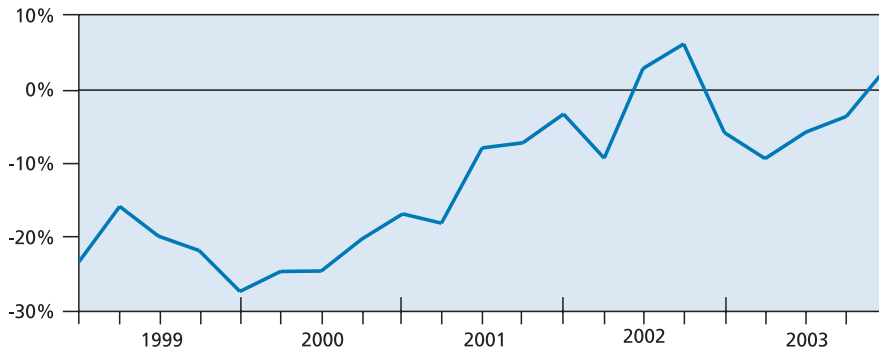
Figures are total return and have been rebased to 100 at 31 December 1998.



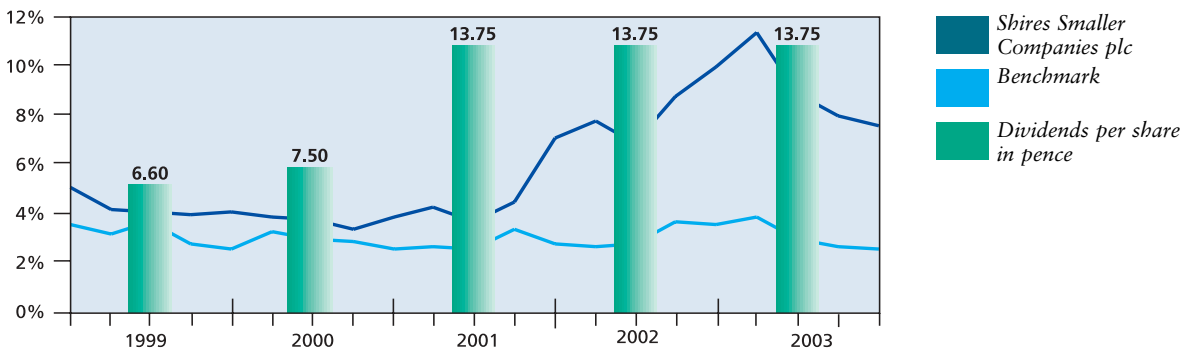
Relative Performance



Premium/(Discount)



Net Dividend Yield





Henry S. Cathcart *Chairman*

Highlights

In my first annual statement to you as Chairman I am pleased to report on a number of positive results for your Company. Net assets have risen by over £6.5 million since the start of the year, with the net asset value per share increasing by 20.3% from 147.6p to 177.6p. Over the same period the share price has risen from 139.5p to 184p and, subject to shareholder approval, the annual dividend will be maintained at the same level as in 2002, producing a dividend yield of 7.5% based upon the share price at 31 December 2003.

Background

Once the war in Iraq concluded, stockmarkets around the world began to make progress as sentiment responded to improving economic forecasts and the prospect of a recovery in business activity. Against this background the share prices of smaller companies, particularly those with growth characteristics, outperformed those of larger capitalisation stocks many of which were affected by the weakness of the US Dollar and the problems of the Eurozone. The FTSE Small Cap Index (excluding Investment Companies), the Company's benchmark, returned 40.9%, well ahead of the 20.9% return on the FTSE All-Share Index.

Investment Performance

The Company's total return on net assets was 29.6%. This good return in absolute terms was below the corresponding return on the benchmark, largely because the Company's dividend objective limits the number of low-yielding equities which may be included in the portfolio.

Over the year there was an improvement in the rating of the Company's shares in the stock market, which moved from a discount of 5.5% to net asset value per share at 31 December 2002 to a premium of 3.6% at 31 December 2003. As a result the total return to a shareholder, at 41.8%, was above the return on net assets.

Earnings & Dividends

The revenue return per share was 14.46p. The Board is recommending a final dividend of 4.75p per share which, together with the interim dividends already paid, takes the total dividends for the year to 13.75p, the same as last year.

If approved at the Annual General Meeting on 19 March 2004, the final dividend will be paid on 31 March 2004 to shareholders on the register at close of business on 5 March 2004.

Portfolio Profile

At 31 December 2003 the Company maintained an ungeared exposure to equities, which represented 98.7% of net assets compared to 101.2% at 31 December 2002.

Over the year total gearing fell from 84.7% to 72.2% of net assets, due to the rise in value of the Company's net assets as the prices of ordinary shares held in the portfolio recovered.

All of the gearing at 31 December 2003 was invested in the high-yielding fixed income securities which make a major contribution to the high level of income distributed to shareholders.

In December 2003 £12.1 million of the zero coupon finance, due to mature on 2 August 2005, was replaced with new financing which will run until December 2008. The cost of the new finance is 5.9% per annum, which compares with 7.2% per annum on the funds repaid.

This refinancing was undertaken in order to secure lower finance costs for a further five year period. In addition, by replacing part of the original financing repayable in 2005, the Board was able to reschedule maturity dates of medium to long-term funding. Previously all such funding was scheduled to mature in the second half of 2005.

Longer Term Strategy

In February 2000 the discount stood at over 30%, a matter of considerable concern to the Board, and in response a change of strategy was introduced in August 2000. The aim was to raise the yield on the Company's shares and seek to minimise the discount at which the ordinary share price stood to the net asset value per share.

To enhance the yield on net assets, additional gearing was introduced by raising £12 million of zero coupon finance. The proceeds of this financing were invested in corporate fixed interest securities, largely of investment grade.

Over the three years to 31 December 2003 the dividend yield averaged 8.8%, the rating of the Company's shares rose from a discount of 16.7% to a premium of 3.6% and the total return to a shareholder was 5.0% per annum, which compared with -4.9% per annum on the FTSE Small Cap Index (excluding Investment Companies).

Dividend Payment Policy

The improvement in the rating of the Company's share price indicates that there is a demand for the shares in the stockmarket which may provide the opportunity to issue periodically new shares at a premium under the existing disapplication of pre-emption rights.

Currently there is a two month time lag between the end of a quarter and the "ex dividend" date in respect of the dividend payment relating to that quarter. New ordinary shares issued during that two-month period, therefore, would offer either the right to dividends which they had not earned or different dividend rights from those shares already in issue. To avoid the impact upon the revenue account of paying unearned dividends on newly issued shares or the complications of maintaining different classes of ordinary share for limited periods of time, the Board has decided to pay the dividend from income earned in each quarter at the end of the first month of the following quarter. The first interim dividend for the year to 31 December 2004, therefore, will be paid on 30 April 2004. The timetable of future dividend payments is shown on Page 41 of the Annual Report.

Implementation of this new policy requires one further change in practice. As a final dividend may not be paid without the approval of shareholders and that cannot be obtained in time to pay a dividend within one month of the fourth quarter's end, the Board has decided to pay four interim dividends each year in future, but no final dividend. These new arrangements will not affect the level of total annual dividends paid per share.

Reclassification

In view of the Company's high income objective and in order to provide a meaningful comparison with other investment trust companies offering a high income, the Board approached the Association of Investment Trust Companies to request that the Company be included in the "UK High Income" rather than the "UK Smaller Companies" category of the Monthly Information Service. The Association agreed to this reclassification which took effect from 31 January 2004.

Outlook

Forecasts of output growth have been raised in most major economies, with the USA continuing to lead the recovery supported by Asia and, in particular, China. The recovery in confidence among investors and the prospect of renewed profits growth suggest that the environment is becoming more supportive of investment in the cyclical, higher-yielding shares which make up a large proportion of the Company's equity portfolio.

Board

The Board was saddened to announce the untimely death of John Stubbs in the 2003 Interim Report but find it a fitting testimony that the strategies introduced under his leadership have led to the elimination of the discount and the recent period of good performance.

Mike Balfour was appointed a member of the Board in November 2003, following an executive search by the Nominations Committee. Mr Balfour has acted as an investment manager for several investment trusts and is now a director of a number of other companies.



Henry S. Cathcart *Chairman*



Directors

Henry S. Cathcart (Chairman)

Age 63. Joined the Board in 1995, appointed as Chairman in July 2003. Chairman of Speymalt Whisky Distributors Limited. Formerly Managing Director of Hill Samuel Scotland Limited and a Director of Hill Samuel Bank Limited.



Michael W. Balfour

Age 43. Joined the Board in November 2003. A member of the Institute of Chartered Accountants of Scotland. Formerly a Director of Edinburgh Fund Managers Group plc and McLeod Russel plc. Presently a Director of DowCarter and Ralph Institutional Advisers and a number of other companies.



Dinah A. Nichols C.B

Age 60. Joined the Board in 1999. A Crown Estate Commissioner and non-executive Director of the Pennon Group plc. Formerly Director General (Environment) at the Department for Environment, Food and Rural Affairs. Formerly non-executive Director of the Carbon Trust, Anglian Water plc and of John Laing ETE.



James G. West

Age 56. Joined the Board in 2002. Formerly Chief Executive of Lazard Asset Management and a Managing Director of Lazard Brothers. Non-executive Director of Candover Investments plc and British Assets Trust plc and Director of other companies.

All Directors are members of the Audit Committee which is chaired by J. G. West and the Nominations Committee which is chaired by H. S. Cathcart.

How the Board Operates

Composition

The Board, which currently consists of four non-executive Directors, met six times during the financial year. H. S. Cathcart, D. A. Nichols and J. G. West attended all meetings. C. J. F. Arnander and A. J. R. Izat attended two meetings up to their retirement on 21 March 2003 and John Stubbs attended three meetings. M. W. Balfour attended one meeting subsequent to his appointment on 14 November 2003. The Board has appointed Glasgow Investment Managers Limited ("Glasgow") to manage the Company's investment portfolio within the guidelines set by the Board and to provide it with accounting and secretarial services. Glasgow is not directly represented on the Board, but key Glasgow investment and secretarial staff attend all Board Meetings to report relevant matters to the Board and to be available to answer any queries from Board members.

Reporting

Glasgow provides the Board with monthly reports on the Company's activities. These include statistics analysing the Company's performance relative to various stockmarket indicators, details of investments purchased and sold, results announcements of investee companies, projections of future income from investments and cash management details. An important part of the induction process for new Directors is guidance on understanding and appraising such data.

Decision Making Process

The Board has a formal schedule of matters specifically reserved to it for decision. These are discussed at regular intervals (and at least once per annum) and comprise corporate matters, the Company's objective, benchmark, advisors, managers and management agreement. When necessary, the managers are requested to withdraw so that the Directors may discuss matters in private.

Nominations Committee

All Directors are members of the Nominations Committee, which is chaired by H. S. Cathcart. This committee met twice during the year. H. S. Cathcart, D. A. Nichols and J. G. West attended both meetings.

Audit Committee

All Directors are members of the Audit Committee which is chaired by J. G. West F.C.A. This committee met twice during the year. The external auditors attended both meetings. Part of one audit committee meeting was conducted without the Managers being present. H. S. Cathcart, D. A. Nichols and J. G. West attended both meetings with C. J. F. Arnander, J. Stubbs and A. J. R. Izat attending one.

Managers' Review

Background

After three years of negative returns, the FTSE All-Share Index produced a positive total return in 2003 of 20.9%. Smaller companies, as measured by the FTSE Small Cap Index (excluding Investment Companies), out-performed the overall stock market with a return of 40.9%. These equity returns compare favourably with the returns from fixed interest securities, the FTSE Actuaries Government Securities All Stocks Index recording a total return of only 2.1%.

At a sector level, the industry groups that performed best were Information Technology, Cyclical Consumer Goods, Non-Cyclical Services, General Industrials and Cyclical Services. The five best performing sectors in 2003 were the worst five in 2002, a sharp reversal in fortunes with growth stocks taking over from value as the main investment focus. Linked to this was a shift in emphasis from high yielding to low yielding equities. The revival in the Information Technology sector explains part of the difference in performance between small and large companies. Technology forms a much larger part of the SmallCap Index than the All-Share Index.

The Shires Smaller Companies portfolio is underweight in the Information Technology sector and is invested in higher yielding equities in order to pay an above average dividend to shareholders. This was the principal reason for underperformance relative to the Company's benchmark in 2003.

Equities

During the year, exposure to equities was reduced from 101.2% of net assets to 98.7% (see page 13). At the sector level, there was an increase in exposure to Cyclical Services and Utilities.

Purchases

During the year a number of new holdings was added to the portfolio.

- Menzies (J) – a wholesale newspaper distributor with a growing aviation services division.
- Regent Inns – operates a small chain of branded and unbranded pubs on the High Street. The shares performed poorly in the summer months and offered an attractive yield together with a potential improvement in trading at their Walkabout bars.
- City Natural Resources High Yield Trust – provides a high yield and capital growth from a portfolio of mining and resources shares, convertibles and fixed interest securities.
- Viridian – an electricity utility based in Northern Ireland. It has power generation mainly in the North and some peripheral interests in telecommunications and out-sourcing services. The high yield is backed by stable revenues.



Hunting is one of the world's leading suppliers of premium goods to the upstream oil and gas industry.

Some holdings were increased.

The investment in Countrywide Assured was increased because housing transactions are forecast to remain strong and the company is planning to de-merge its insurance business. In the Chemical sector, the investment in Zotefoams was increased to benefit from its attractive yield, as was XP Power in the Electronic & Electrical Equipment sector. The exposure to Cyclical Services was raised with new investments and additional purchases of DFS Furniture.

Sales

A number of the Trust's investments was the subject of takeover bids, including Thistle Hotels, Wilson Connolly, Intercare and Stirling Group.

During the year several other holdings were disposed of in their entirety.

Small holdings in Incepta Group, Volex, Virt X and CLS Holdings were sold to give the portfolio greater focus. The exposure to General Retailers was also reduced as trading conditions were expected to deteriorate and the holdings in Merchant Retail and Homestyle were sold. After a period of strong share price performance, Belhaven was sold to invest for higher yield, as was Barratt Developments, also after a period of good performance. The Insurance sector suffered in the stock market downturn and Britannic Group was sold after being unable to pay its dividend.

In addition, a number of holdings was reduced.

In Financials, the investments in both Intermediate Capital and Cattles performed well and were reduced because they appeared fully valued. As a result of these sales, the companies concerned no longer appear in the list of the ten largest investments. The holding in Peacock Group was also reduced as part of the overall reduction in the weighting in General Retailers. As Dairy Crest recovered from the problems it encountered last year in the cheese market the share price rating improved, providing an opportunity to take some profits.

Fixed Income Securities

The proportion of the Trust invested in Convertibles, Corporate Bonds and Other Fixed Interest declined from 83.5% to 73.5% of net assets, largely because of the rise in value of the equity portfolio.

From the second quarter of 2003, fixed income securities provided lower returns than equities as investors anticipated a recovery in corporate profits. Returns from bonds were also affected by the change in trend of interest rates which began to rise in the third quarter of 2003. High yielding corporate bonds performed better than government securities because investors were less cautious and preferred the recovery potential in corporate stocks.



A Malcolm Group Volvo FH12 Globetrotter at Loch Lomond.

Within the corporate bond portfolio, the holdings in Bank of Scotland 8.117% and National Westminster 7.625% were reduced. A new investment was made in Big Food Group 9.75% bonds, which offers an attractive yield with recovery prospects as new management improves the company's food retail business.

In the Convertibles portfolio, Wace Group 8% was sold, Hampson Industries 6.5p was redeemed and a new holding added in Impax 5.5%, an environmental management company.

Exposure to Convertible Preference shares was increased from 2.6% to 6.7% of net assets due to the attractive yields available. The existing holdings in Co-operative Bank 9.25%, Bellway 9.5% and Ecclesiastical Ins 8.625% were increased. New holdings were established in PZ Cussons 10% and East Surrey Water 7.8%. The holding in H.P. Bulmer 8.75% was sold when the company was taken over.

Strategy

The economic background is supportive of equities and improving company profit forecasts offer the prospect of another year of positive returns. Although interest rates were raised in November 2003 and again in February 2004, the outlook is for further gradual rises in bank base rates to around 4.5% by the end of the year. Consumer spending growth started to decelerate in the second half of 2003 but this year should see a rise in business investment to compensate. Public sector spending remains firm and will contribute to UK aggregate output growth, which is expected to be about 3% this year.

Smaller companies have performed strongly and recovered most of the previous undervaluation relative to large market capitalisation stocks. This year investment returns are likely to be influenced by improving economic conditions and a recovery in takeover and merger activity. Within the smaller company sector, the Company will continue to invest in undervalued companies with high, well-covered dividend yields.

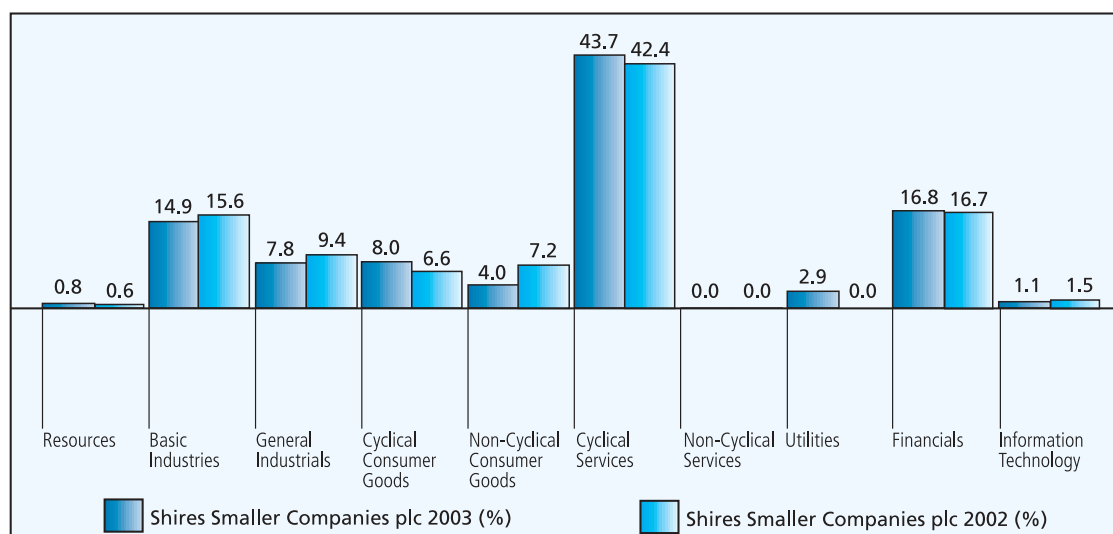


A development of retirement flats by McCarthy & Stone called Highbury Court at King's Heath, Birmingham.

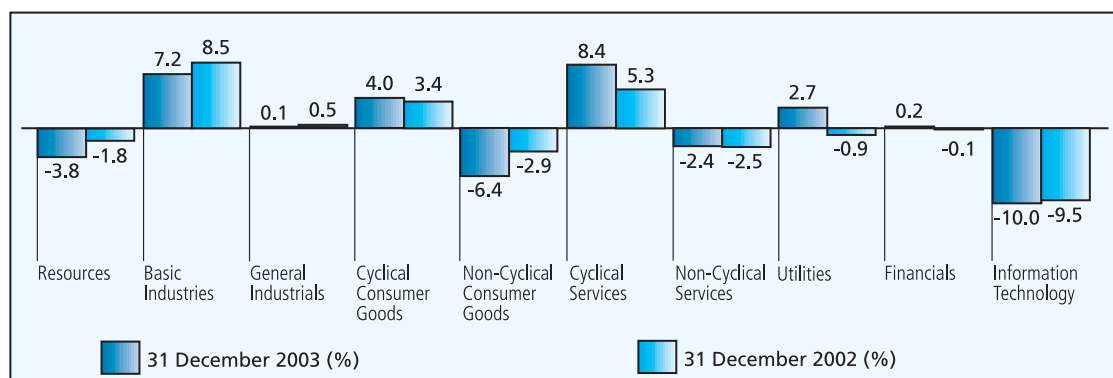
Distribution of Assets and Liabilities

	Valuation at 31 December 2002		Movements during the year			Valuation at 31 December 2003	
	£000	%	Purchases £000	Sales £000	Appreciation/ (Depreciation) £000	£000	%
Listed Investments							
Ordinary Shares	32,706	101.2	9,654	(11,839)	7,833	38,354	98.7
Convertibles	3,577	11.1	3,324	(3,469)	(520)	2,912	7.5
Corporate Bonds	22,547	69.8	3,355	(4,109)	1,281	23,074	59.3
Other fixed interest	831	2.6	7,825	(6,158)	115	2,613	6.7
	<u>59,661</u>	<u>184.7</u>	<u>24,158</u>	<u>(25,575)</u>	<u>8,709</u>	<u>66,953</u>	<u>172.2</u>
Net current liabilities	(3,170)	(9.8)				(2,309)	(5.9)
TOTAL ASSETS (less current liabilities)	56,491	174.9				64,644	166.3
Long-term loan	(9,984)	(30.9)				(9,989)	(25.7)
Zero coupon finance	(14,199)	(44.0)				(15,785)	(40.6)
NET ASSETS	<u>32,308</u>	<u>100.0</u>				<u>38,870</u>	<u>100.0</u>
NET ASSET VALUE PER SHARE	<u>147.6p</u>					<u>177.6p</u>	

Analysis of Listed Equity Portfolio at 31 December 2003 (based on value of Ordinary Shares above)



Shires Smaller Companies plc relative to the FTSE SmallCap Index (excl Investment Companies)



Portfolio of Investments

as at 31 December 2003

	Market value £000	% of total assets
ORDINARY SHARES		
Pendragon	3,071	4.8
James Fisher & Sons	2,609	4.0
Dawson Holdings	2,026	3.1
British Vita	1,560	2.4
D.F.S. Furniture	1,520	2.4
Menzies J	1,260	1.9
Peacock	1,233	1.9
Northgate	1,144	1.8
Viridian	1,105	1.7
FKI	1,070	1.7
Countrywide Assured	992	1.5
Regent Inns	962	1.5
XP Power	955	1.5
Arriva	950	1.5
Development Securities	884	1.4
Dairy Crest	880	1.4
Aggregate Industries	855	1.3
Intermediate Capital	845	1.3
Zotefoams	820	1.3
SIG	813	1.3
Diploma	788	1.2
City Natural Resources High Yield Trust	787	1.2
Interserve	720	1.1
London Scottish Bank	679	1.0
Cattles	669	1.0
Nestor Healthcare	668	1.0
Shanks	662	1.0
McCarthy & Stone	646	1.0
New Look	604	0.9
Aberforth Geared Income	577	0.9
The Malcolm Group	575	0.9
Salvesen (Christian)	570	0.9
Woolworths	569	0.9
Marshalls	542	0.8
600 Group	488	0.8
Henlys	488	0.8
London Merchant Securities	487	0.8
Scottish Radio Holdings	443	0.7
AFA Systems	420	0.6
Delta	405	0.6
Other (6)	1,013	1.6
	<u>38,354</u>	<u>59.4</u>
CONVERTIBLES		
Balfour Beatty 10.75p	1,570	2.4
Hunting 8.25%	936	1.4
Impax 5.5%	234	0.4
Emess 6.25p	172	0.3
	<u>2,912</u>	<u>4.5</u>
CORPORATE BONDS		
Anglian Water Services Financing 7.882% 2037	2,984	4.6
Northumbrian Water Finance 6.0% 2017	2,568	4.0
Bank of Scotland 8.117% 2010*	2,342	3.6
Scottish Mutual 7.25% 2021*	2,295	3.6
National Westminster 7.625% 2010	2,266	3.5
Woolworths Group 8.75% 2006	2,080	3.2
Luxfer Holdings 10.125% 2004/09*	2,062	3.2
RWE Finance 4.625% 2010*	1,629	2.5
Carnival 7.125% 2012	1,526	2.4
Transco 5.375% 2009	1,502	2.3
Lafarge 6.875% 2012*	1,062	1.6
Big Food Group 9.75% 2012	746	1.2
Energis 9.125% 2005/10*	12	0.0
	<u>23,074</u>	<u>35.7</u>
PREFERENCE SHARES		
Co-Op Bank 9.25%	701	1.1
PZ Cussons 10%	580	0.9
Ecclesiastical Insurance 8.625%	549	0.8
Bellway 9.5% 2014	370	0.6
East Surrey Water 7.8%	333	0.5
Aggregate Inds 11.25% 2005	80	0.1
	<u>2,613</u>	<u>4.0</u>
	66,953	103.6
Net current liabilities	(2,309)	(3.6)
Total assets	<u>64,644</u>	<u>100.0</u>

All investments are listed on the London Stock Exchange (sterling based), except for the investments marked with * which are listed overseas (all sterling based).

Historical Record

Capital History¹

As at 31 December	Total assets less current liabilities £m	Shareholders' funds £m	Net asset value per share		Share price p	Premium/ (Discount) %
			Undiluted p	Fully diluted p		
1993	19.5	19.5	155.6	146.3	146.0	(0.2)
1994	28.0	28.0	144.7	137.3	131.0	(4.6)
1995	40.0	30.0	154.9	145.8	136.0	(6.7)
1996	44.0	34.0	176.2	163.9	133.5	(18.5)
1997	47.0	37.0	190.0	176.8	154.5	(12.6)
1998	44.8	34.8	177.5	166.9	128.0	(23.3)
1999	57.8	47.8	243.3	228.7	166.0	(27.4)
2000	74.9	52.5	240.1	240.1	200.0	(16.7)
2001	67.5	44.3	202.4	202.4	196.5	(2.9)
2002	56.5	32.3	147.6	147.6	139.5	(5.5)
2003	64.6	38.9	177.6	177.6	184.0	3.6

Cumulative Performance^{2,3}

As at 31 December	NAV (fully diluted)	NAV total return ⁴	Share price performance	Share price total return ⁴	(FTSE SmallCap Index excluding Investment Companies)	
					Benchmark performance	Benchmark total return ⁴
1993	100.0	100.0	100.0	100.0	100.0	100.0
1994	93.9	97.3	89.7	93.0	94.4	97.5
1995	99.7	107.4	93.2	100.7	106.0	112.9
1996	112.0	125.2	91.4	103.3	120.6	133.6
1997	120.9	139.8	105.8	124.5	127.1	145.4
1998	114.1	136.3	87.7	107.2	111.6	131.3
1999	156.3	193.0	113.7	144.9	166.3	201.5
2000	164.1	208.9	137.0	181.6	172.8	215.4
2001	138.4	186.3	134.6	189.6	142.4	182.0
2002	100.9	146.5	95.6	145.5	100.1	131.5
2003	121.4	192.1	126.0	210.2	136.9	185.2

Revenue History¹

As at 31 December	Fully diluted earnings per share p	Rebased ³	Dividends per ordinary share		Retail price index	Total expense ratio %
			Rebased ³	Rebased ³		
1993	5.43	100.0	5.05	100.0	100.0	1.41
1994	6.30	116.0	5.40	106.9	102.9	1.25
1995	6.21	114.4	5.70	112.9	106.2	1.35
1996	6.05	111.4	6.00	118.8	108.8	1.53
1997	6.18	113.8	6.20	122.8	112.8	1.60
1998	5.72	105.3	6.40	126.7	115.9	1.58
1999	7.67	141.3	6.60	130.7	117.9	1.47
2000	8.27	152.3	7.50	148.5	121.4	1.46
2001	13.52	249.0	13.75	272.3	122.2	1.77
2002	13.77	253.6	13.75	272.3	125.8	2.09
2003	14.46	266.3	13.75	272.3	129.3	2.24

¹ Data supplied by Glasgow Investment Managers Limited.

² Data supplied by Fundamental Data for the Association of Investment Trust Companies.

³ Rebased to 100 at 31 December 1993.

⁴ Total return figures are based on reinvestment of net income.

Directors' Report

Status of the Company

The Company, which was incorporated in 1992, has received approval as an investment trust by the Inland Revenue for all accounting periods up to and including 31 December 2002 and has since continued to conduct its affairs so as to enable it to retain such approved status. This approval is subject to there being no subsequent enquiry under corporation tax self assessment. It is a member of the Association of Investment Trust Companies. The Company is an investment company within the meaning of Section 266 of the Companies Act 1985. So far as the Directors are aware the close company provisions of the Income and Corporation Taxes Act 1988 do not apply to the Company.

Results and Dividends

The financial statements for the year ended 31 December 2003 appear on pages 25 to 38.

A final dividend of 4.75p per share is proposed which, together with the interim dividends already paid, takes the total dividends for the year to 13.75p per share (2002 – 13.75p).

Activities

The Company is an investment trust. Its subsidiary undertaking, Shirescot Securities Limited, operates as an investment dealing company.

Review of the Business

A review of the business is given in the Chairman's Statement and the Investment Managers' Review.

Directors

The Directors are shown on page 8. All held office throughout the year with the exception of M. W. Balfour who was appointed on 14 November 2003. J. Stubbs served as a Director until his death on 26 July 2003. A. J. R. Izat and C. J. F. Arnander served as Directors until they retired on 21 March 2003. M. W. Balfour, having been appointed since the last Annual General Meeting, retires from office and offers himself for election. H. S. Cathcart retires by rotation and, being eligible, offers himself for re-election.

There were no contracts subsisting during or at the end of the year in which any Director was materially interested.

Directors' Interests in Shares

The interests of the Directors in office at 31 December 2003 in the ordinary 50p shares in the Company were as follows:

		Beneficial interest		Non-beneficial interest
	31 December 2003	31 December 2002	31 December 2003	31 December 2002
H. S. Cathcart	15,531	11,337	–	–
J. G. West	10,000	–	–	–

D. A. Nichols had no interests in the capital of the Company at any time during the year. M. W. Balfour had no interests in the capital of the Company at any time from the date of his appointment to 31 December 2003.

H. S. Cathcart held part of his beneficial holdings through The Glasgow PEP and The Glasgow ISA. As a result of standing arrangements to acquire shares in the Company by monthly purchases and/or reinvestment of dividends, his beneficial holdings have increased during the period 1 January 2004 to 6 February 2004 as follows:

	Number of shares
H. S. Cathcart	87

There have been no other changes in the Directors' interests between 1 January 2004 and 6 February 2004.

Corporate Governance

The Board has in place Corporate Governance arrangements which it believes are appropriate for an investment trust company and enable the Company to comply with the relevant Principles of Good Governance and Code of Best Practice (“the Combined Code”) published by the Committee on Corporate Governance in June 1998. Subject to the special circumstances of the Company as an investment trust, the Company has complied with the provisions set out in Section 1 of the Combined Code throughout the year.

The Board notes the publication of the new Code on Corporate Governance and the AITC Code of Corporate Governance and is reviewing these with the aim of implementing the relevant principles in the forthcoming year.

The Board

The Board currently consists of four non-executive Directors who are independent of the Company’s Managers, Glasgow Investment Managers Limited (“Glasgow”). Details of the Directors appear on page 8.

The Board considers that the post of chief executive officer is not relevant in the context of an investment trust as this role has effectively been delegated to Glasgow. Similarly, the Board does not believe that there is a need for a senior independent director, in addition to the separate roles of Chairman and Chairman of the Audit Committee.

The Board has appointed Glasgow to manage the Company’s investment portfolio within guidelines set by the Board and to provide it with accounting and secretarial services. Glasgow provides the Board with monthly reports on the Company’s activities. The Board has a formal schedule of matters specifically reserved to it for decision including an annual review of the Managers and management agreement. There is an agreed procedure for Directors to take independent professional advice if necessary and at the Company’s expense. This is in addition to the access which every Director has to the advice of Glasgow as Secretaries of the Company.

Audit Committee

The Audit Committee comprising all Directors of the Company meets at least twice a year to coincide with the annual and interim reporting cycle. The Chairman is J. G. West. The principal role of the Audit Committee is to review the annual and interim financial statements, the accounting policies applied therein and ensure compliance with financial and regulatory reporting requirements. The external auditors, whose continued appointment is also reviewed and ratified by the Audit Committee, attend at least one meeting of the Audit Committee per year.

Nominations Committee

The Nominations Committee, comprising all Directors of the Company, considers appointments of new Directors undertaking a thorough and open process involving professional recruitment consultants and, subsequently, committee interviews with the candidates identified. Under the Articles of Association, (i) new Directors are subject to re-election at the first Annual General Meeting after their appointment, (ii) all Directors retire in rotation and (iii) a Director who has reached the age of seventy must retire at the end of the next Annual General Meeting. Directors do not have a service contract or fixed term in office, but in accordance with the Articles they are required to submit themselves for re-election every three years. As the composition of the Board is expected to reflect a breadth of commercial, professional and industrial experience, new Directors are provided with sufficient guidance and instruction to enable them to understand the economic environment in which investment trusts operate and carry out effective and objective evaluation of the Company’s performance therein.

Relations with shareholders

All shareholders have the opportunity to attend and vote at Annual General Meetings at which the Board and the Managers are available to discuss key issues affecting the Company.

As recommended by the Combined Code, the Company announces the proxy votes cast at general meetings.

At least twenty working days’ notice is given of the Annual General Meeting.

Internal Control

The Board is ultimately responsible for the Company's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

Under the Combined Code, it is a requirement that the Board reviews the effectiveness of the Company's system of internal controls at least annually, comprising all controls including financial, operational, compliance and risk management. To achieve this, the Board has in place regular review procedures for the identification, evaluation and management of significant risks to the Company, to enable full compliance with guidance issued in September 1999 by the Turnbull Committee. This process has been in place throughout the year under review and up to the date of approval of the Annual Report.

The Board has delegated certain functions. The main service providers are Glasgow, the Managers and Secretaries; HSBC Bank plc, the custodian; and Lloyds TSB Registrars Scotland, the registrars. Glasgow provides the Board with monthly reports, which cover investment activities and financial matters, and with periodic reports on its control procedures and its system of internal financial control. An independent custodian, HSBC Bank plc, is appointed to safeguard the Company's investments, which are registered in the name of the custodian's nominee company. In view of the controls that are in place, the Directors do not consider that there is any need for an internal audit function.

Investment Manager – Glasgow Investment Managers Limited (“Glasgow”)

Performance

The principal objective of the Company is to provide a high and growing dividend and capital growth from a portfolio invested principally in the ordinary shares of smaller UK companies and fixed income securities.

The portfolio, as managed by Glasgow Investment Managers, has consistently achieved a high level of income generation which has supported a relatively high dividend yield compared to the Company's benchmark, the FTSE Small Cap Index (excluding Investment Companies). In terms of capital performance over the last five years the Company has outperformed significantly in relation to Share Price Return although it is below the benchmark for Net Asset Value Return over the same period. Performance statistics are shown on page 4. Page 15 contains details of the 10 year historical record.

The Board considers that Glasgow is managing the Company in a manner which is fulfilling the objectives of the Trust and its shareholders.

Investment Management Agreement

The key terms of the Investment Management Agreement and specifically, the fee charged by Glasgow and how it is calculated are set out in note 3 to the financial statements. The Board believes the fee charged by Glasgow is competitive with reference to other investment trusts with a similar investment mandate and is not excessive given the level of service provided by Glasgow.

Summary

In the opinion of the Directors the continuing appointment of Glasgow on the terms agreed is in the interest of Shareholders as a whole.

Compliance with the Provisions of the Combined Code

Subject to the special circumstances of the Company as an investment trust, the Company has complied with the provisions set out in Section 1 of the Combined Code throughout the year and up to the date of approval of this Annual Report.

Going Concern

The Board considers that the Group has adequate financial resources to continue in operational existence for the foreseeable future. For this reason it continues to apply the going concern basis in preparing the financial statements.

Responsibilities as an Institutional Shareholder

In October 2002, The Institutional Shareholders' Committee, of which the AITC is a member, published a Statement of Principles setting out best practice guidelines designed to enable institutional shareholders to derive the best possible value out of the companies in which they invest. The following General Policy is a statement of the procedures and policies followed by the Board in discharging the responsibilities over all investee companies.

General Policy

The Board delegates to the Managers, Glasgow, responsibility for selecting the portfolio of investments, within investment guidelines established by the Board after discussions with Glasgow, and for monitoring the performance and activities of investee companies. Glasgow carries out detailed research of investee companies and possible future investee companies by a combination of broker and internally generated research, assisted by independent research consultants. The research on a company comprises an evaluation of fundamental details such as financial strength, quality of management, market position and product differentiation, plus an appraisal of issues relevant to it including environmental matters. Glasgow's monthly reports to the Board include details of the performance of investee companies.

The Company's voting rights in respect of investee companies are delegated to the Managers, who do not automatically exercise these votes in pursuit of a fixed policy, but consider each case on its merits. The primary aim of the use of voting rights is to ensure a satisfactory return from investments.

Payment Policy

The Company's policy, in relation to all of its suppliers, is to settle the terms of payment when agreeing the terms of the transaction and to abide by those terms. The Company does not have trade creditors.

Substantial Interests

As at 6 February 2004 the Company had received notification of the following interests in its ordinary shares:

	Number of Shares	% of total
Shires Income plc	6,286,808	28.7
Universities Superannuation Scheme Limited	713,709	3.3
In addition, the Company is aware of the following substantial interests in its ordinary shares as at 6 February 2003:		
Glasgow Investment Managers Limited as manager of the Glasgow Trustplan, The Glasgow PEP and The Glasgow ISA	1,670,431	7.6

Directors' Remuneration Report

In accordance with the Directors' Remuneration Report Regulations 2002, the report, which appears on page 21, must be approved by the Directors and laid before the Members of the Company at the same time as the audited financial statements and be the subject of a separate resolution as part of the Ordinary Business at the Annual General Meeting. The outcome of the vote on this resolution has no practical or legal effect and its sole function is to enable Members to demonstrate whether or not they are in agreement with the Board's policies in this matter and the rates of remuneration which the Directors decide to pay themselves. Accordingly, Resolution 2 will be proposed as an ordinary resolution to enable Members either to show that they approve of the contents of the Directors' Remuneration Report by voting 'For' the resolution, or to show their disapproval by voting 'Against' the resolution.

Authority to disapply statutory pre-emption rights

The power given to Directors at the last Annual General Meeting to allot shares for cash otherwise than in accordance with the statutory pre-emption rights expires on the date of the forthcoming Annual General Meeting. Since in certain circumstances it may be in the best interests of the Company to issue shares for cash otherwise than *pro rata* to existing shareholders, the Directors consider that it is appropriate for this power to be renewed at the forthcoming Annual General Meeting. Accordingly, Resolution 7 will be proposed as a special resolution giving the Directors power to allot for cash, as if section 89(1) of the Companies Act 1985 did not apply, equity securities in connection with a rights issue and, provided the shares are issued at a price not less than their underlying fully diluted net asset value, in other cases up to an aggregate nominal amount of £1,094,327, which is equivalent to approximately 10% of the present issued ordinary share capital of the Company. This power will require to be renewed at the Annual General Meeting in 2005. New shares will be issued only in compliance with the policies of the UK Listing Authority concerning the issuing of new shares for cash.

Authority to buy back shares

The resolution passed at the last Annual General Meeting to authorise the Company to make market purchases of up to 14.99% of its own ordinary shares expires on the date of the forthcoming Annual General Meeting. Accordingly, Resolution 8 will be proposed as a special resolution to renew this authority for a further year.

Auditors

A resolution re-appointing KPMG Audit Plc as auditors and authorising the Directors to determine their remuneration will be proposed at the Annual General Meeting.

By Order of the Board

Glasgow Investment Managers Limited

Secretaries

16 February 2004

Directors' Remuneration Report

Policy

The Board as a whole reviews and sets the rates of remuneration payable to each Director annually. The Board is aware that these should be comparable to market rates in order to attract and retain directors of the appropriate calibre and reflect the time spent and responsibilities borne by Directors in exercising the stewardship required of this Company. In setting these rates, the Board acts principally on advice from the Managers, Glasgow Investment Managers Limited ("Glasgow"), who monitor rates of directors' remuneration in companies of comparable size and activities and carry out any other relevant research requested by the Board. No separate remuneration committee has been constituted in view of the level of work delegated to Glasgow. Further details of the services provided by Glasgow are contained in note 3 to the financial statements.

The Board considers that the present policy to remunerate Directors exclusively by fixed fees in cash is appropriate and adequate for the Company in its present and foreseeable circumstances and there are no plans to introduce additional or alternative remuneration schemes.

No Director has a service contract with the Company or its subsidiary undertaking.

Directors' Remuneration Rates

From 1 January 2003 to 30 June 2003 the annual rates of remuneration were £15,000 for the Chairman and £10,000 for each other Director. These rates were in place from October 2001. The present annual rates of remuneration with effect from 1 July 2003 are £18,000 for the Chairman, £14,000 for the Chairman of the Audit Committee and £12,000 for each other Director. The rates for the forthcoming year commencing 1 January 2004 will be subject to annual review on 1 July 2004.

The Articles of Association of the Company set a maximum aggregate limit within a financial year for non-executive directors' remuneration. This limit, which was last adjusted by special resolution at the Annual General Meeting of the Company held on 23 March 2001, is £70,000 per annum, subject to annual upward adjustment on 1 January each year in line with the change in the Retail Price Index from December 2000. The limit for the year ended 31 December 2003 was therefore £72,561 and the limit for the forthcoming year to 31 December 2004 is £74,593.

The total fee payable to each Director who served during the present and previous financial years of the Company is shown in the following table (audited):

	Group and Company	
	2003	2002
	£	£
H. S. Cathcart (Chairman)	13,500	10,000
M. W. Balfour (appointed 14 November 2003)	2,000	–
D. A. Nichols	11,000	10,000
J. G. West	12,000	7,500
J. Stubbs (died 26 July 2003)	9,000	15,000
C. J. F. Arnander (retired 21 March 2003)	2,500	10,000
A. J. R. Izat (retired 21 March 2003)	2,500	10,000
	<u>£52,500</u>	<u>£62,500</u>

There is no performance related remuneration scheme such as an annual bonus, or a long-term incentive scheme such as the granting of share options. The Company does not operate a pension scheme for the Directors and no Director received any form of remuneration during the present or preceding financial year other than the fees shown above.

Performance

The Absolute Performance graph on page 5 of this Annual Report shows the total return to an investor in the Company as measured both on a share price basis and on a net asset value basis, both with dividends reinvested, during the five years ended 31 December 2003, together with the performance over the same period of the FTSE SmallCap Index – excluding Investment Companies (Total Return), the benchmark index most appropriate to this Company.

Approved by the Board of Directors on 16 February 2004 and signed on its behalf.

H. S. Cathcart, Chairman

Directors' Responsibilities in relation to the preparation of the Financial Statements

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the total return of the Group for the year then ended. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- apply the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors confirm that the financial statements comply with these requirements.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial positions of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Independent Auditors' Report to the Members of Shires Smaller Companies plc _____

We have audited the financial statements on pages 25 to 38. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's Members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's Members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's Members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report and the Directors' Remuneration Report. As described on page 22, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent Auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the Directors is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on pages 17 and 18 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report, including the corporate governance statement and the unaudited part of the Directors' Remuneration Report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Independent Auditors' Report to the Members of Shires Smaller Companies plc (Continued)

Basis of Audit Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2003 and of the total return of the Group for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Glasgow
16 February 2004

Consolidated Statement of Total Return

(incorporating the Revenue Account*)
for the year ended 31 December 2003

	Notes	2003			2002		
		Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Gains/(Losses) on investments	11	-	8,709	8,709	-	(10,148)	(10,148)
Income	2	4,205	-	4,205	4,184	-	4,184
Investment management fee	3	(260)	(260)	(520)	(289)	(289)	(578)
Other administrative expenses	4	(283)	-	(283)	(254)	-	(254)
NET RETURN BEFORE FINANCE COSTS AND TAXATION		3,662	8,449	12,111	3,641	(10,437)	(6,796)
Finance costs:							
Loans and overdrafts	6	(497)	(497)	(994)	(612)	(612)	(1,224)
Zero coupon finance	16	-	(1,546)	(1,546)	-	(955)	(955)
RETURN ON ORDINARY ACTIVITIES BEFORE TAXATION		3,165	6,406	9,571	3,029	(12,004)	(8,975)
Taxation	7	-	-	-	(15)	15	-
RETURN ON ORDINARY ACTIVITIES AFTER TAXATION FOR THE FINANCIAL YEAR		3,165	6,406	9,571	3,014	(11,989)	(8,975)
Dividends on equity shares	9	(3,009)	-	(3,009)	(3,009)	-	(3,009)
TRANSFER TO/(FROM) RESERVES		156	6,406	6,562	5	(11,989)	(11,984)
Return per share	10	14.46p	29.27p	43.73p	13.77p	(54.78)p	(41.01)p
Dividends per share	9	13.75p			13.75p		

*The revenue column of this statement is the consolidated revenue account of the Group.

The accompanying notes are an integral part of this statement.

All revenue and capital items in the above statement derive from continuing operations.

No operations were acquired or discontinued in the year

Balance Sheets

as at 31 December 2003

	Notes	Group		Company	
		2003 £000	2002 £000	2003 £000	2002 £000
FIXED ASSETS					
Listed investments	11	66,953	59,661	66,953	59,661
Subsidiary undertaking	12	–	–	–	–
		66,953	59,661	66,953	59,661
CURRENT ASSETS					
Debtors	13	734	961	881	1,101
Investments of dealing subsidiary undertaking	14	147	140	–	–
Cash at bank		465	89	465	89
		1,346	1,190	1,346	1,190
CREDITORS					
Amounts falling due within one year	15	(3,655)	(4,360)	(3,655)	(4,360)
NET CURRENT LIABILITIES		(2,309)	(3,170)	(2,309)	(3,170)
TOTAL ASSETS LESS CURRENT LIABILITIES		64,644	56,491	64,644	56,491
CREDITORS					
Amounts falling due after more than one year	16	(25,774)	(24,183)	(25,774)	(24,183)
NET ASSETS		38,870	32,308	38,870	32,308
CAPITAL AND RESERVES					
Called up share capital	17	10,943	10,943	10,943	10,943
Share premium account	18	11,490	11,490	11,490	11,490
Capital redemption reserve	19	2,032	2,032	2,032	2,032
Realised capital reserve	20	9,031	13,926	9,031	13,926
Unrealised capital reserve	20	4,396	(6,905)	4,396	(6,905)
Revenue reserve	21	978	822	978	822
EQUITY SHAREHOLDERS' FUNDS	26	38,870	32,308	38,870	32,308
Net asset value per share	10	177.6p	147.6p		

Approved by the Board of Directors on 16 February 2004 and signed on its behalf.

H. S. Cathcart, *Chairman*

The accompanying notes are an integral part of these balance sheets.

Consolidated Cash Flow Statement

for the year ended 31 December 2003

	Notes	2003		2002	
		£000	£000	£000	£000
OPERATING ACTIVITIES					
Dividends and interest received from investments			4,415		4,060
Income tax recovered			-		108
Deposit interest received			10		10
Other cash received			1		2
Administrative expenses paid			(858)		(638)
Payments to and on behalf of Directors			(55)		(71)
Dealing subsidiary payments			-		(171)
NET CASH INFLOW FROM OPERATING ACTIVITIES	23		3,513		3,300
SERVICING OF FINANCE					
Interest paid			(535)		(1,228)
TAXATION					
Corporation tax paid			-		(4)
INVESTING ACTIVITIES					
Purchases of investments		(24,158)		(34,400)	
Sales of investments		25,575		38,609	
NET CASH INFLOW FROM INVESTING ACTIVITIES			1,417		4,209
EQUITY DIVIDENDS PAID			(3,009)		(3,009)
FINANCING					
Zero coupon finance			40		-
INCREASE IN CASH	25		1,426		3,268

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements

1. ACCOUNTING POLICIES

The financial statements of the Company and the Group have been prepared in accordance with applicable accounting standards and, except as referred to in paragraphs (e) and (g) below, in accordance with the Statement of Recommended Practice (SORP) issued by the Association of Investment Trust Companies in 2003. The effects on capital and income of the items involving departures from the SORP are set out under Risk Management – Income Enhancement in note 27. The principal accounting policies are as follows:

(a) Accounting convention

The financial statements are prepared under the historical cost convention as modified to include the revaluation of fixed asset investments and on the assumption that approval as an investment trust will continue to be granted.

(b) Consolidation

The Group financial statements consolidate the results of the Company and its subsidiary undertaking under the acquisition method of accounting. The Company has availed itself of the relief from showing a revenue account for the parent company, granted under section 230 of the Companies Act 1985.

(c) Investments

Listed investments are valued at middle market prices at close of business on the balance sheet date.

(d) Gains and losses on investment transactions

Company

Gains and losses arising on sales of investments are taken to realised capital reserve. Unrealised appreciation or depreciation of investments is taken to unrealised capital reserve.

Investment dealing subsidiary undertaking

Investments held are shown as current assets at the lower of cost and market value. Gains and losses arising on the sale of these investments are dealt with in the revenue account.

(e) Income and expenditure

Dividends are credited to revenue on the date when the investment is first quoted ex-dividend at the amount receivable without any attributable tax credit.

The SORP requires that income from preference shares be recognised on an effective yield basis. The Directors consider that this is not appropriate for a high-yielding investment trust because the effective yield basis does not recognise the fact that the dividend declared and paid on a preference share is in fact an appropriation of, and not a charge against, profit.

Interest from deposits, interest payable and expenses of management are dealt with on an accruals basis. Income from debt securities is accounted for on an effective yield basis.

The finance costs of borrowings and the fee payable to the Company's managers are charged partly to capital and partly to revenue in proportion to the expected long-term split of returns in the form of capital gains and income from the Company's entire investment portfolio.

All other expenses of management are charged to revenue. Expenses which are incidental to the purchase or sale of an investment are included within the cost or deducted from the sale proceeds of the investment.

The Company has in place medium-term funding in the form of zero coupon finance through a series of option transactions on the FTSE 100 Index. As a result of the specific design of the strategy, the net movement in the value of the options is treated as a charge to capital at a constant rate over the life of the options. This represents a departure from the SORP which recommends that finance costs are allocated between capital and revenue in accordance with the Board's expected long-term split of returns. In making a charge wholly to capital, this follows the accounting treatment for zero dividend preference shares, for which the SORP accepts the finance costs may be charged to capital. This form of finance represents a cheaper and more flexible alternative to zero dividend preference shares. The costs associated with the zero coupon finance are shown as a separate component of finance costs on the face of the Consolidated Statement of Total Return.

Underwriting commission is taken to revenue, unless any shares underwritten are required to be taken up, in which case the proportionate commission received is deducted from the cost of the investment.

Notes to the Financial Statements

(continued)

1. ACCOUNTING POLICIES (continued)

(f) Finance costs and long-term borrowings

Long-term borrowings are stated at the amount of the proceeds of issue net of expenses. The finance costs, being the difference between the net proceeds of borrowing and the total amount of payments that require to be made in respect of that borrowing, accrue evenly over the life of the borrowing and are allocated between capital and revenue as stated in note (e) above.

(g) Taxation

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date at rates expected to apply when they crystallise, based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

The SORP requires that a transfer should be made from income to capital equivalent to the tax value of any management expenses that arise in capital but are utilised against revenue. The Directors consider that this requirement is not appropriate for an investment trust with an objective to provide a high and growing dividend that does not generate a corporation tax liability. Given there is only one class of shareholder and hence overall the net effect of such a transfer to the net asset value of the shares is nil no such transfer has been made.

(h) Foreign currencies

Transactions involving foreign currencies are converted at the rate ruling at the time of the transaction. Assets and liabilities in foreign currencies are translated at the closing rates of exchange at the balance sheet date. Any gain or loss arising from a change in exchange rate subsequent to the date of the transaction is included as an exchange gain or loss in capital reserve or the revenue account as appropriate.

2. INCOME

	2003 £000	2002 £000
Income from investments		
UK dividend income	2,491	2,533
UK unfranked investment income	988	1,005
Overseas interest	712	665
	<hr/>	<hr/>
	4,191	4,203
Other income		
Deposit interest	6	10
Underwriting commission	1	2
Profits less losses of dealing subsidiary undertaking	7	(31)
	<hr/>	<hr/>
	14	(19)
TOTAL INCOME	<hr/>	<hr/>
	4,205	4,184

Dividend income includes special dividends totalling £71,000 (2002 – £Nil).

UK dividend income includes £197,000 (2002 – £291,000), i.e. 4.7% of income, raised from the purchase of securities which were subsequently sold within one month. The net capital losses on these transactions amounted to £233,000 (2002 – £338,000).

Notes to the Financial Statements

(continued)

3. SECRETARIAL AND MANAGEMENT FEE

Glasgow Investment Managers Limited (“Glasgow”) acts as investment managers and secretaries to the Company under a contract which is subject to one year’s notice of termination. The fee is at an annual rate of 0.75% of the amount of shareholders’ funds plus medium and long-term funding calculated monthly and paid quarterly. The fee for the year ended 31 December 2003 was £463,000 (2002 – £512,000) exclusive of VAT. £20,000 (plus VAT) of the annual total fee is in respect of secretarial services and is allocated to revenue. The remainder of the fee is allocated 50% to capital and 50% to revenue. The Company also pays Glasgow an annual fee of £4,000 (plus VAT) for services in relation to the Company’s participation in The Glasgow PEP. At 31 December 2003 the total amount of these fees owed to Glasgow (exclusive of VAT) was £125,000 (2002 – £114,000).

Shires Income plc has a substantial minority interest in Glasgow. At 31 December 2003, Shires Income plc had a 28.7% (2002 – 28.7%) interest in the shares of Shires Smaller Companies plc.

4. OTHER ADMINISTRATIVE EXPENSES

	2003 £000	2002 £000
Directors’ remuneration – fees as directors	53	63
Fees payable to auditors and associates – as auditors	13	13
– for other services	11	2
Other management expenses	206	176
	<u>283</u>	<u>254</u>

5. DIRECTORS’ REMUNERATION

The Company had no employees during the year (2002 – Nil). No pension contributions were paid for Directors (2002 – £Nil).

Further details on Directors’ Remuneration can be found in the Directors Remuneration Report on page 21.

6. FINANCE COSTS OF BORROWINGS

	2003			2002		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Loan repayable in one to two years	453	453	906	–	–	–
Loan repayable in two to five years	–	–	–	453	453	906
Bank loans and overdrafts	44	44	88	159	159	318
	<u>497</u>	<u>497</u>	<u>994</u>	<u>612</u>	<u>612</u>	<u>1,224</u>

7. TAXATION

All management expenses arising on Revenue items brought forward from previous years and arising this year were relieved against taxable revenue. By relieving £677,000 of surplus management expenses arising on Capital items against the remaining taxable revenue, the Company eliminated its corporation tax charge. In accordance with accounting policy 1(g) described on page 29 no amount (2002 – £15,000) has been credited to Capital and charged to Revenue as a notional corporation tax item.

At 31 December 2003, the investment trust had net surplus management expenses and loan relationship deficits of £6,025,000 (2002 – £5,862,000) in respect of which a deferred tax asset has not been recognised. This is because the trust is not expected to generate taxable income in a future period in excess of the deductible expenses and deficits of that future period and, accordingly, it is unlikely that the fund will be able to reduce future tax liabilities through the use of existing surplus expenses and loan relationship deficits.

Notes to the Financial Statements

(continued)

7. TAXATION (continued)

The following table is a reconciliation of the current taxation (charge)/credit to the charges or credits which would arise if all ordinary activities were taxed at the standard UK corporation tax rate of 30% (2002 – 30%):

	2003			2002		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Return on Ordinary Activities before Taxation	3,165	6,406	9,571	3,029	(12,004)	(8,975)
Taxation of Return on Ordinary Activities at the standard rate of corporation tax	(950)	(1,922)	(2,872)	(909)	3,601	2,692
Effects of:						
UK dividend income not liable to further tax	747	–	747	760	–	760
Capital gains/(losses) not liable to capital gains tax	–	2,613	2,613	–	(3,044)	(3,044)
Zero Coupon finance costs not an allowable tax deduction	–	(464)	(464)	–	(287)	(287)
Utilisation of management expenses charged to capital	203	(227)	(24)	135	(254)	(119)
Timing differences	–	–	–	(1)	(1)	(2)
Current taxation (charge)/credit for the year	–	–	–	(15)	15	–

8. REVENUE AFTER TAXATION FOR THE FINANCIAL YEAR

The revenue after taxation for the financial year includes £3,158,000 (2002 – £3,016,000) which has been dealt with in the Company's financial statements.

9. DIVIDENDS ON EQUITY SHARES

	2003		2002	
	p	p	£000	£000
Interims paid	9.00	9.00	1,969	1,969
Proposed final	4.75	4.75	1,040	1,040
	<u>13.75</u>	<u>13.75</u>	<u>3,009</u>	<u>3,009</u>

10. RETURN AND NET ASSET VALUE PER SHARE

The returns per share are based on the following figures:

	2003	2002
Revenue return	£3,165,000	£3,014,000
Capital return	£6,406,000	£(11,989,000)
Weighted average number of shares	21,886,538	21,886,538

Net asset value per share is based on net assets attributable to shareholders of £38,870,000 (2002 – £32,308,000) and on the 21,886,538 (2002 – 21,886,538) shares in issue at 31 December 2003.

Notes to the Financial Statements

(continued)

11. FIXED ASSET INVESTMENTS

	Group and Company	
	2003	2002
	£000	£000
Listed on recognised stock exchanges:		
In the United Kingdom	57,551	56,693
Overseas	9,402	2,968
	<u>66,953</u>	<u>59,661</u>
		Group and Company
		£000
Cost at 31 December 2002		66,566
Unrealised depreciation at 31 December 2002		(6,905)
Valuation at 31 December 2002		<u>59,661</u>
Purchases		24,158
Sales – proceeds		(25,575)
– net realised losses on sales		(2,592)
Movement in unrealised appreciation during the year		11,301
Valuation at 31 December 2003		<u>66,953</u>
Cost at 31 December 2003		62,557
Unrealised appreciation at 31 December 2003		4,396
Valuation at 31 December 2003		<u>66,953</u>

For an analysis of investments between equity and fixed interest securities and for detailed interest rates, see page 14.

	Group and Company	
	2003	2002
	£000	£000
Net realised (losses)/gains on sales	(2,592)	934
Movement in unrealised appreciation/(depreciation)	11,301	(11,082)
Gains/(Losses) on investments	<u>8,709</u>	<u>(10,148)</u>

Notes to the Financial Statements

(continued)

12. SUBSIDIARY UNDERTAKING

	Company	
	2003 £000	2002 £000
Shares at cost	—	—

The Company owns the whole of the issued ordinary share capital of its sole subsidiary undertaking, Shirescot Securities Limited, an investment dealing company registered in Scotland.

13. DEBTORS

	Group		Company	
	2003 £000	2002 £000	2003 £000	2002 £000
Amounts falling due within one year:				
Taxation recoverable	4	4	—	—
Accrued income	714	942	714	942
Due by subsidiary undertaking	—	—	151	144
Other debtors	16	15	16	15
	<u>734</u>	<u>961</u>	<u>881</u>	<u>1,101</u>

14. INVESTMENTS OF DEALING SUBSIDIARY UNDERTAKING

	Group	
	2003 £000	2002 £000
At lower of cost and market value:		
Listed in the United Kingdom	147	140

The market value of the investments held at 31 December 2003 was £147,000 (2002 – £140,000).

15. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2003 £000	2002 £000	2003 £000	2002 £000
Bank loans and overdrafts	1,950	3,000	1,950	3,000
Proposed dividend	1,040	1,040	1,040	1,040
Other creditors	665	320	665	320
	<u>3,655</u>	<u>4,360</u>	<u>3,655</u>	<u>4,360</u>

Interest on short-term bank loans and overdrafts is at floating rates related to UK base rates.

Notes to the Financial Statements

(continued)

16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group and Company	
	2003	2002
	£000	£000
Zero coupon finance	15,785	14,199
Long-term loan	9,989	9,984
	<u>25,774</u>	<u>24,183</u>

Zero coupon finance

The zero coupon finance arrangement comprises a set of separately traded financial instruments (FTSE 100 Index options). The difference between the net proceeds raised and the financial obligations of the Company when these options expire or are assigned or exercised constitutes the cost of this finance. This is treated as a charge to realised capital reserve and shown as a separate component of finance costs on the face of the Consolidated Statement of Total Return.

On 11 December 2003 76.5% of the zero coupon finance which had an expiry/assignment/exercise date of 2 August 2005 was rolled over into a new arrangement which runs until December 2008 with additional funds of £12,144,000 being raised, of which £12,104,000 was applied to the settlement of the existing arrangement resulting in a net cash inflow of £40,000. This rollover resulted in an additional charge to capital of £504,000 due to the carrying value of the options being below the market value as a result of the accounting policy adopted as explained in note 1(e).

The finance cost charged to capital is 5.9% per annum for the new arrangement and 7.2% per annum for the remainder of the existing arrangement. These amounts are charged constantly throughout each financial period and added to the amount outstanding at the end of the period.

As at 31 December 2003, the Company had pledged collateral equal to at least 111% of the market value of this finance in accordance with standard commercial practice.

The movements in the book value of this finance were as follows:

	Group and Company	
	2003	2002
	£000	£000
At 31 December 2002	14,199	13,244
Proceeds from new zero coupon finance arrangement	12,144	–
	<u>26,343</u>	<u>13,244</u>
Cost of partial closure of existing zero coupon finance arrangement	(12,104)	–
	<u>14,239</u>	<u>–</u>
Finance costs charged to capital	1,042	955
Charge on rollover of zero coupon finance	504	–
	<u>1,546</u>	<u>955</u>
Total zero coupon finance costs charged to capital		
At 31 December 2003	<u>15,785</u>	<u>14,199</u>

At 31 December 2003, the market values of the components of this finance were as follows:

	Group and Company	
	2003	2002
	£000	£000
Written options	21,570	31,773
Purchased options	(4,822)	(16,435)
	<u>16,748</u>	<u>15,338</u>

Notes to the Financial Statements

(continued)

16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (continued)

Long-term loan

The long-term loan, which was taken out in 1995, is stated at the principal amount of £10,000,000 less expenses. Interest is fixed at 9% per annum on the principal amount and is payable in arrears on 30 June and 31 December in each year. The loan is repayable at par on 31 December 2005 and is secured by a floating charge over the whole of the property and undertaking of the Company.

The Directors' opinion of the fair value of the long-term loan at 31 December 2003, determined by reference to the current interest profile of similar instruments, was £10,884,000.

17. CALLED UP SHARE CAPITAL

	Number	Ordinary shares of 50 pence each £000
Authorised		
At 31 December 2002 and 31 December 2003	35,000,000	17,500
Allotted, called up and fully paid		
At 31 December 2002 and 31 December 2003	21,886,538	10,943

18. SHARE PREMIUM ACCOUNT

	£000
At 31 December 2002 and 31 December 2003	11,490

At 31 December 2003 the share premium account included £972,000 (2002 – £972,000) which was originally received as proceeds of issues of warrants to subscribe for ordinary shares. All of these warrants were subsequently exercised and the proceeds transferred from a warrants reserve.

19. CAPITAL REDEMPTION RESERVE

	£000
At 31 December 2002 and 31 December 2003	2,032

20. OTHER CAPITAL RESERVES

	Group and Company £000
Realised capital reserve	
At 31 December 2002	13,926
Net losses on sales of investments during the year	(2,592)
Finance costs of borrowings (note 6)	(497)
Zero coupon finance costs (note 16)	(1,546)
Investment management fee	(260)
At 31 December 2003	9,031
Unrealised capital reserve	
At 31 December 2002	(6,905)
Movements during the year:	
Fixed asset investments	11,301
At 31 December 2003	4,396

The capital reserves are not distributable.

Notes to the Financial Statements

(continued)

21. REVENUE RESERVE

	Group £000	Company £000
At 31 December 2002	822	822
Transfer from revenue account	156	156
At 31 December 2003	<u>978</u>	<u>978</u>

22. ANALYSIS OF CHANGES IN FINANCING

	Share capital £000	Share premium £000	Capital redemption reserve £000	Long- term loan £000	Zero coupon finance £000	Total £000
At 31 December 2002	10,943	11,490	2,032	9,984	14,199	48,648
Finance costs	-	-	-	5	1,546	1,551
Net proceeds of zero coupon finance rollover	-	-	-	-	40	40
At 31 December 2003	<u>10,943</u>	<u>11,490</u>	<u>2,032</u>	<u>9,989</u>	<u>15,785</u>	<u>50,239</u>

23. RECONCILIATION OF NET REVENUE BEFORE FINANCE COSTS AND TAXATION TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2003 £000	2002 £000
Net revenue before finance costs and taxation	3,662	3,641
Investment management fee charged to capital	(260)	(289)
Decrease/(Increase) in accrued income	228	(143)
(Increase)/Decrease in other debtors	(1)	1
(Decrease)/Increase in other creditors	(109)	122
Increase in dealing investments	(7)	(140)
Repayment of UK income tax	-	108
Net cash inflow from operating activities	<u>3,513</u>	<u>3,300</u>

24. ANALYSIS OF CHANGES IN NET DEBT

	At 31 December 2002 £000	Cash flows £000	Other non-cash changes £000	At 31 December 2003 £000
Cash at bank and in hand	89	376	-	465
Bank loans and overdrafts	(3,000)	1,050	-	(1,950)
Long-term loan	(9,984)	-	(5)	(9,989)
Zero coupon finance	(14,199)	(40)	(1,546)	(15,785)
	<u>(27,094)</u>	<u>1,386</u>	<u>(1,551)</u>	<u>(27,259)</u>

Notes to the Financial Statements

(continued)

25. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	2003 £000	2002 £000
Increase in cash at bank and in hand	376	89
Decrease in bank loans and overdrafts	1,050	3,179
Increase in cash during the year	1,426	3,268
Net proceeds of zero coupon finance rollover	(40)	–
Change in net debt resulting from cash flows	1,386	3,268
Zero coupon finance costs	(1,546)	(955)
Deferred finance costs of long-term loan	(5)	(6)
Movement in net debt	(165)	2,307
Net debt at 31 December 2002	(27,094)	(29,401)
Net debt at 31 December 2003	(27,259)	(27,094)

26. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	2003 £000	2002 £000
Total revenue returns	3,165	3,014
Dividends	(3,009)	(3,009)
Transfer to distributable reserves	156	5
Total capital returns	6,406	(11,989)
Net increase/(decrease) in shareholders' funds	6,562	(11,984)
Shareholders' funds at 31 December 2002	32,308	44,292
Shareholders' funds at 31 December 2003	38,870	32,308

27. RISK MANAGEMENT, FINANCIAL ASSETS AND LIABILITIES

The following information is given in accordance with Financial Reporting Standard 13, "Derivatives and Other Financial Instruments: disclosures".

Risk Management

The Company's objective of providing a high and growing dividend with capital growth is addressed by investing in smaller UK market capitalisation equities to provide growth in capital and income and in fixed income securities to provide a high level of income.

The impact of security price volatility is reduced by diversification and by hedging instruments. Diversification is by type of security – ordinary shares, preference shares, convertibles, corporate fixed interest and gilt-edged – and by investment in the stocks and shares of companies in a range of industrial, commercial and financial sectors. The management of the portfolio is conducted according to investment guidelines, established by the Board after discussion with the Managers, which specify the limits within which the Managers are authorised to act.

The Company is subject to interest rate risk because bond yields are linked to underlying bank rates or equivalents, and its short-term borrowings and cash resources carry interest at floating rates. The interest rate profile is managed as part of the overall investment strategy of the Company.

Notes to the Financial Statements

(continued)

27. RISK MANAGEMENT, FINANCIAL ASSETS AND LIABILITIES (continued)

Financial Assets and Liabilities

The Group's financial assets include investments, cash at bank and short-term debtors. Financial liabilities consist of bank loans and overdrafts, other short-term creditors and long-term creditors arising from option contracts and a fixed rate term loan.

The book value of cash at bank and bank loans and overdrafts included in these financial statements approximate to fair value because of their short-term maturity. Investments held as dealing investments are valued at the lower of cost and market value. The carrying values of fixed asset investments are stated at their fair values, which have been determined with reference to quoted market prices. For details of bond maturities and interest rates, see page 14. For all other short-term debtors and creditors, their book values approximate to fair values because of their short-term maturity.

As at 31 December 2003, the weighted average number of years to redemption of the corporate bond portfolio was 11.7 years (2002 – 12.1 years) and the weighted average interest yield on the portfolio was 7.5% (2002 – 7.6%).

Gearing

The Company issued a 9% secured loan in 1995 and augments this from time to time with short-term borrowings so that greater returns to shareholders may be generated from the capital stock thus enlarged. Although this gearing increases the opportunity for gain, it also increases the risk of loss in falling markets. The risk of increased gearing is managed by retaining the flexibility to reduce both short-term borrowings and the zero coupon finance as appropriate.

Income Enhancement

Zero coupon finance (note 16) raised in the derivatives market is invested in corporate fixed interest securities and convertibles to augment the income available for distribution to shareholders. The cost of these funds is fixed when they are raised, and is charged wholly to capital.

In addition, as explained in note 1(g) revenue is utilising surplus management expenses that have arisen in capital but not compensating capital as recommended by the SORP.

The effect of these income enhancement strategies on capital and income is summarised in the table below. There is a risk with these strategies that capital will be eroded unless the charges to capital are covered by gains elsewhere in the portfolio, and this is managed by investing in a portfolio of shares which in the long run is expected to provide adequate capital growth to absorb both the zero coupon finance cost and the capital cost of buying in income while paying growing dividends which contribute to the pursuit of the Company's objectives.

In following this strategy, the Directors recognise that there is only one class of shareholder.

	2003		2002	
	Income £000	Capital £000	Income £000	Capital £000
Zero coupon finance				
Finance costs charged to capital	–	(1,546)	–	(955)
Return on corresponding investments	850	641	835	(750)
Purchases of preference shares cum-dividend and sales ex-dividend	197	(233)	291	(338)
Tax value of management expenses arising in capital but utilised against income	203	(203)	–	–
	<u>1,250</u>	<u>(1,341)</u>	<u>1,126</u>	<u>(2,043)</u>

28. COMMITMENTS AND CONTINGENCIES

At 31 December 2003 there were no contingent liabilities in respect of outstanding underwriting commitments or uncalled capital (2002 – £150,000).

Glasgow Investment Managers Limited

(Authorised and regulated by the Financial Services Authority).

Glasgow Investment Managers (“Glasgow”), the company which manages Shires Smaller Companies plc, is principally owned by its directors and staff with an investment trust (Shires Income plc) holding the remaining interest.

Glasgow also manages two other investment trust companies:

- Shires Income plc
- Glasgow Income Trust plc

Shares in Shires Smaller Companies plc, Shires Income plc and Glasgow Income Trust plc are also available within The Glasgow Investment Collection as detailed on page 41.

This page and page 41 are issued and approved by Glasgow Investment Managers Limited, who is authorised and regulated by the Financial Services Authority. Past performance is not indicative of future performance. The price of shares and the income from them may go down as well as up and it is possible that investors may not get back the full amount invested on disposal of the shares. Changes in the rates of exchange may cause the value of overseas investments to go down or up. High income investments, in order to meet their income objectives, may charge expenses to capital which in turn may erode the capital value of the investment to less than the amount invested. Funds that invest in the securities of smaller companies are likely to carry a higher degree of risk than most funds. In certain circumstances, the Manager may enter into derivatives transactions in order to manage risk in the portfolio and generate income. The market in these instruments can be highly volatile and there is a high risk of loss. Derivatives may only be used subject to the restrictions set out for the Trust.

Gearing

Investment Trusts have the facility to borrow, which is known as “gearing”. Shires Smaller Companies plc participates in gearing. Normally, gearing is measured as a percentage. A gearing percentage of 110% means that an Investment Trust with equity of £100 million, has £10 million of borrowing(s). The level of gearing can change quite significantly depending on fluctuations in market levels. When there is a change in value of the Investment Trust’s underlying portfolio the use of gearing may result in exaggerated movements in the Trust’s net asset value. Gearing may also result in Investment Trust price movements being more volatile than the price movements in the Trust’s underlying investment portfolio.

The favourable tax treatment of PEPs and ISAs is subject to government legislation, and as such may be changed. The value of tax relief will depend upon your individual circumstances.

Glossary of Technical Terms

Benchmark

A market index which averages the performance of the share prices of companies in any given sector, thus providing an indication of movements in the stockmarket. The benchmark used in these accounts is the total return on the FTSE SmallCap Index (excluding Investment Companies), a recognised and respected index which measures the performance of around 400 quoted UK companies each with a market capitalisation below £250 million.

Convertibles

Fixed income securities which may be converted into shares.

Corporate Bond

A fixed interest bond issued by a company. Corporate bonds are given grades which show how likely a company is to pay the interest and repay the capital owed at the end of the term. Investment grade bonds are considered to have a lower risk of default which means interest on the loan and the loan itself is almost certainly going to be paid back. Non-investment grade bonds carry a higher risk for investors as there is deemed to be a greater chance the company issuing the bond may default.

Preference Shares

These entitle the holder to a fixed rate of dividend out of the profits of the Company, to be paid in priority to dividends on other classes of shares.

Discount

The amount by which the market price per share of an investment trust is lower than the net asset value per share. The discount is normally expressed as a percentage of the net asset value per share.

Gearing

The term applied to the effect of borrowings on assets which will increase the return on investments when the value of the Company's investments is rising but reduce the return when values are declining. A level of 0% indicates there is no gearing.

Net Asset Value

Also described as shareholders' funds. Net Asset Value is the value of total assets less liabilities. Liabilities for this purpose include medium and long-term borrowings as well as current liabilities. The Net Asset Value per share is calculated by dividing this amount by the number of ordinary shares in issue.

Premium

The amount by which the market price per share of an investment trust is higher than the net asset value per share. The premium is normally expressed as a percentage of the net asset value per share.

Total Assets

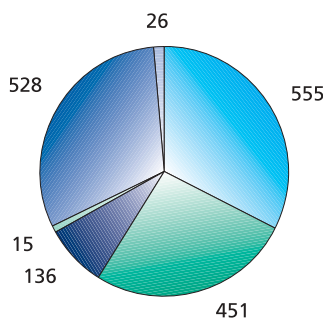
Total assets less current liabilities.

Total Expense Ratio

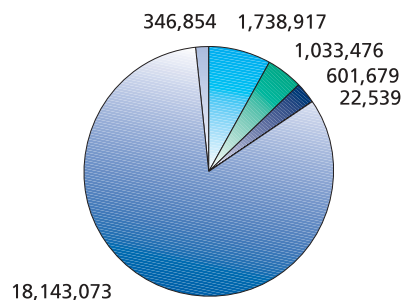
Total annual operating costs (net of tax relief), excluding interest costs, divided by the average shareholders' funds (calculated according to Association of Investment Trust Companies' guidelines).

Analysis of Shareholders *as at 31 December 2003*

Number of Shareholders (1,711)



Number of Shares held (21,886,538)



Annual General Meeting

This year's AGM will be held at Trinity House, Tower Hill, London EC3N 4DH on Friday, 19 March 2004 at 12 noon.

Financial Calendar for 2004/2005

31 March 2004	Final dividend 2003 payable
30 April	First interim dividend 2004 payable
30 July	Second interim dividend 2004 payable
August	Interim results announcement
August	Interim results publication
29 October	Third interim dividend 2004 payable
31 January 2005	Fourth interim dividend 2004 payable

Price and Net Asset Value Information

The price of the ordinary shares, which are listed on the London Stock Exchange, is quoted in the *Financial Times*, *The Daily Telegraph* and *The Herald*. The Company's Net Asset Value is calculated weekly and announced to the London Stock Exchange.

Cost of shares and warrants for capital gains tax

The ordinary shares and warrants were first issued on the Company's flotation in 1992. A further issue of shares and warrants was made in 1994. For shareholders subscribing at the time of these issues, the acquisition costs for capital gains tax, adjusted for indexation to 5 April 1998, were as follows:

1992 subscriptions		1994 subscriptions	
– Ordinary shares	113.15p	– Ordinary shares	162.13p
– Warrants	19.55p	– Warrants	88.95p

The Glasgow Investment Collection

The Glasgow Investment Collection was launched in January 2004. It offers the opportunity for investors to choose to invest in one or a combination of all of the following three investment trusts: Shires Income plc, Glasgow Income Trust plc and Shires Smaller Companies plc, the investment trusts managed by Glasgow Investment Managers Limited ("Glasgow"). These investments can be made through an ISA, TrustPlan, PEP Transfer or a new Children's Savings Plan.

The Glasgow Investment Collection offers:

- Regular Monthly Savings, from as little as £20 per month.
- Lump Sum Investment from £200.
- PEP or ISA Transfers
- A Share Exchange Scheme
- Dividend Reinvestment

Further information may be obtained from Glasgow on FREEFONE 0800 435 797.

Share Register enquiries

The Company's Registrars, Lloyds TSB Registrars Scotland, maintain the share register. In the event of queries regarding your shares, please contact the Registrars on 0870 601 5366. Changes of name or address must be notified in writing to Lloyds TSB Registrars Scotland, PO Box 28448, Finance House, Orchard Brae, Edinburgh EH4 1WQ.

Shareview website

The Registrars provide an on-line service that enables shareholders to access details of their shareholdings. A shareholder wishing to view the information, together with additional information such as indicative share prices and details of recent dividends, should visit www.shareview.co.uk.

Shares held in nominee names

Where notification has been received in advance, the Company will provide nominee companies with copies of shareholder communications for distribution to their customers. Shareholders holding their shares in nominee names may, if appointed as a proxy by the nominee company, attend general meetings and speak when invited by the Chairman.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the twelfth Annual General Meeting of the Members of Shires Smaller Companies plc will be held at Trinity House, Tower Hill, London, EC3N 4DH on Friday, 19 March 2004 at 12 noon to transact the following business:

Ordinary Business

1. To receive and adopt the Directors' Report and audited financial statements for the year ended 31 December 2003.
2. To receive and adopt the Directors' Remuneration Report for the year ended 31 December 2003.
3. To declare a final dividend.
4. To elect M. W. Balfour as a Director.
5. To re-elect H. S. Cathcart as a Director.
6. To re-appoint KPMG Audit Plc as auditors of the Company and to authorise the Directors to determine their remuneration.

Special Business

To consider and, if thought fit, pass the following resolutions which will be proposed as special resolutions:

7. That the Directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 ("the Act") to allot equity securities for cash as if subsection 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited
 - (i) to the allotment of equity securities in connection with a rights issue where it is, in the opinion of the Directors, necessary or expedient to deal with problems under the laws of any overseas territory or the requirements of any regulatory body or any Stock Exchange in any overseas territory or in connection with fractional entitlements; and
 - (ii) to the allotment (otherwise than pursuant to (i) above) of ordinary shares up to an aggregate nominal amount of £1,094,327 at a price per share not less than the fully diluted net asset value of an ordinary share in the Company calculated as at the close of business on the immediately preceding business day,

and shall expire at the conclusion of the Annual General Meeting of the Company in 2005 but so that this power shall enable the Company to make offers or agreements before the expiry of this power which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offers or agreements as if the power conferred hereby had not expired and for this purpose words and expressions defined in or for the purpose of Part IV of the Act shall bear the same meanings in this resolution.
8. That the Company be and it is hereby generally and unconditionally authorised to make market purchases of any of its own ordinary shares in such manner and upon such terms as the Directors of the Company may from time to time determine, provided that
 - (i) the maximum aggregate nominal value of the ordinary shares hereby authorised to be acquired shall be limited to £1,640,396, being equal to approximately 14.99% of the ordinary shares in issue;
 - (ii) the maximum price which may be paid for any ordinary shares shall not exceed an amount equal to 105% of the average of the market values of such ordinary shares, as defined in the Listing Rules of the Financial Services Authority, for the five business days before the purchase is made and the minimum price shall be 50p per ordinary share (in each case exclusive of expenses); and

(iii) the authority hereby conferred shall expire (unless previously revoked or renewed) on 19 March 2005 or at the conclusion of the next Annual General Meeting of the Company held after the passing of this Resolution, whichever is the later, provided that the Company may before such expiry make any contract of purchase of ordinary shares which would or might be executed wholly or partly after the expiry of such authority and the Company may make such a purchase in pursuance of such contract as if the authority hereby conferred had not expired.

By Order of the Board

Glasgow Investment Managers Limited

Secretaries

17 February 2004

Note:

A member of the Company entitled to attend and vote at the Meeting may appoint a proxy to attend and, on a poll, vote in place of him. A proxy need not be a member of the Company. A form of proxy is enclosed which, if required, should be completed in accordance with the instructions thereon. Completion and return of the proxy will not preclude a member from attending and voting in person.



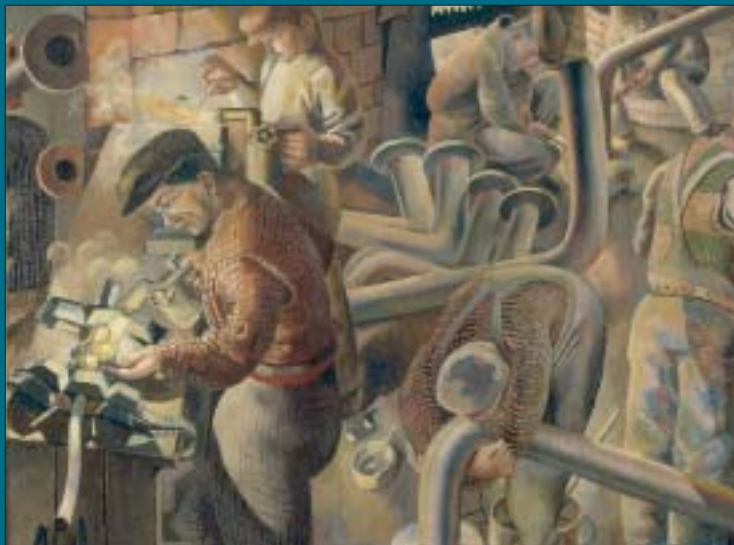
Glasgow Investment Managers Limited, Sutherland House, 149 St Vincent Street, Glasgow G2 5DR
Tel: 0141 572 2700 Fax: 0141 572 2777 Email: information@gimltd.co.uk

Authorised and regulated by the Financial Services Authority

SHIRES SMALLER COMPANIES PLC

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